UNIVERSITY OF THE WITWATERSRAND

TAXING FACEBOOK: USER DATA AND PARTICIPATION AS TAXABLE ASSETS

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Research Report for a Master's degree by coursework and research report: A research report submitted to the Faculty of Commerce, Law and Management, University of the Witwatersrand, Johannesburg, in partial fulfilment of the requirements for the degree of Master of Law (Specialising in Taxation Law).

DECLARATION

I declare that this research report is my own unaided work.

It is submitted in partial fulfilment of the requirements for the degree of Master of Law (specialising in taxation) at the University of the Witwatersrand, Johannesburg.

It has not been submitted before for any other degree or examination in any other university.

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Abstract

Facebook is said to have 2.93 billion active users and it is estimated that by 2026 the number of Facebook users in South Africa will reach 35.92 million. Facebook is said to generate 98.5% of its revenue from digital advertising in the form of targeted advertisements on Facebook and Instagram. A plausible case can be made about the contribution of user data to the profitability of a highly digitalised company such as Meta Platforms Incoporated. This research report has identified three fundamental problems. First, Meta Platforms Incoporated extracts data from users and generate profits through targeted advertising at the location of the user without paying sufficient income tax in the user jurisdiction. Secondly, there is a fundamental problem with how South Africa deals with the income taxation of companies such as Meta Platforms Incoporated. Thirdly, the current tax rules do not allow for taxation to take place at the location of the user and therefore need to be revised. This research report therefore provides five potential solutions that South Africa can adopt to impose income tax on Meta Platforms Incoporated. The solutions include first, the use of the South African source rules (source being at the location of the server); secondly the use of the South African source rules (source being at the location of the Internet Service Provider); thirdly a tax akin to the mineral royalty tax in the form of a data royalty tax; fourthly the OECD’s Two Pillar Proposal; and fifthly unilateral legislative solutions (using Nigeria and India as a case study).

Key words: Facebook users, income tax, source rules, business profits, multinational enterprises

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Table of Abbreviations

Amount A	Amount A applies to multinational enterprises (MNE) with revenues exceeding EUR 20 million and a profitability greater than 10%. It reallocates 25% of the MNE's profit in excess of 10% of its revenues to the market jurisdiction.
AWS	Amazon Web Service
BEPS	Base Erosion Profit Shifting
EBIT	earnings before interest and taxes
EU	European Union
Facebook	Meta Platforms Incorporated. Facebook also refers to the social networking website.
GDP	Gross Domestic Product
ISP	Internet Service Providers
ITA	The Income Tax Act 58 of 1962
Nexus	A sufficient physical presence: it is the determining factor of whether a foreign company is liable for tax in the jurisdiction in which it operates.
MLC/ MLA	Multilateral Convention/ Multilateral Agreement
MNE	Multinational enterprise
NRC	Non-resident company
OECD	The Organisation for Economic Co-operation and Development
PE	Permanent Establishment
POPIA	The Protection of Personal Information Act 4 of 2013
SARS	South African Revenue Service
SEP	significant economic presence model
SME	small and medium enterprise
The MPRD Act	The Mineral and Petroleum Resources Development Act 28 of 2002
The Royalty Act	The Mineral and Petroleum Resources Royalty Act 28 of 2008
User	A user of the Facebook platform who is also a South African Tax resident

1. INTRODUCTION

1.1. *Background and Context*

Recent statistics have shown that more than 95 million people across sub-Saharan Africa access Facebook with 97% using their mobile devices to access the social media platform.[1] With specific reference to South Africa, it is estimated that in 2021, 95% of internet users used WhatsApp, 87% Facebook and 73% Instagram.[2] As such, Meta Platforms Incoporated,[3] had an estimated South African audience of 24.2 million that it had reached through advertising and this number is likely to increase exponentially over the next few years.[4] Furthermore, Facebook is said to generate 98.5% of its revenue from digital advertising in the form of targeted advertisements on Facebook and Instagram.[5] The fundamental issue identified by the author is that Facebook does not pay its fair share of taxes at the user jurisdiction and the current manner in which South Africa taxes Facebook on business profits generated in South Africa is inefficient. This research report, therefore, proposes a more efficient way of taxing the business profits generated by Facebook from Users' data. The proposed method makes use of the location of the Users' ISPs to not only confer the right to tax Facebook but also, to allocate a share of the profits to the country in question.[6]

1.2. *Research Aims*

This research report has identified three fundamental problems. First, social media companies like Facebook extract data from Users and generate profits through targeted advertising at the location of the User without paying sufficient income tax in the user jurisdiction. Secondly, there is a fundamental problem with how South Africa has dealt with the income taxation of companies such as Facebook. Thirdly, the current tax rules do not allow for taxation to take place at the location of the User and therefore need to be revised.

This research report aims to provide five potential solutions that South Africa can adopt to impose income tax on Facebook. The solutions include first, the use of the South African source rules (location of the server); secondly the use of the South African source rules (location of the ISP); thirdly a tax

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[1] Statista 'Leading social media platforms in South Africa 2021' available at *https://www.statista.com/statistics/1189958/penetration-rate-of-social-media-in-south-africa/* ,accessed on 18 June 2022.

[2] C Fuchs (2018) 'The online advertising tax: A digital Policy Innovation' University of Westminster Press at 4-11.

[3] Hereinafter referred to as Facebook.

[4] Fuchs op cit note 2 at 5-6.

[5] Rishi Iyengar (2020) 'Here's how big Facebook's ad business is' CNN Business available at *https://edition.cnn.com/2020/06/30/tech/facebook-ad-business-boycott/index.html*, accessed on 20 June 2022.

[6] AW Oguttu & B Van der Merwe 'Electronic Commerce: Challenging the Income Tax Base' (2005) 17 *SA Mercantile Law Journal* at 305-15.

akin to the mineral royalty tax in the form of a data royalty tax; fourthly the OECD’s Two Pillar Proposal; and fifthly unilateral legislative solutions as applied by Nigeria and India.[7] The basis for choosing Nigeria and India as comparators is that, like South Africa, they are growing economies with a large and growing population of Users and other social media platforms like WhatsApp and Instagram. In addition, India and Nigeria are not members of the OECD and therefore, their decisions to adopt unilateral domestic legislative measures to tax NRC should be analysed. This report will not provide an in-depth analysis of the five potential solutions but instead, it offers a high-level overview and it hopes to provide a foundation for further research.

The scope of this research report is limited to companies and not other types of legal persons. Moreover, the recommendations proposed in this report are limited to social media companies that extract data from users and use the same data to engage in target marketing in the user jurisdiction.

1.3. *The Structure of the research report*

This research report is divided into the following two parts: part one (chapters two to four) presents a case for taxing value generated by Users under South African domestic law; while part two (chapters five to seven) deals with international tax law and the impact of the OECD’s work on international tax law.

Chapter two introduces the data economy and explains Facebook's business model. Furthermore, it highlights the rapid growth in the number of South African Users and Facebook's ability to monetise data in the form of hyper-targeted advertising on its platform. This lays the foundation to discuss the importance of Users and User data in Facebook’s business model and the connection between source-based taxation and value creation concerning the data economy.

Chapter three evaluates South Africa’s present source rules to determine if they are appropriate for taxing Facebook. The chapter considers s9 of the ITA and the common law as formulated by case law, to determine if Facebook’s business profits can be generated from a South African source. Furthermore, this chapter analyses the concept of source by considering Facebook’s business model and assessing whether the current source rules are effective, given the increasing rate of active South African users on Facebook.

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[7] Hereinafter the five potential solutions.

Chapter four presents the argument that South Africa has progressive source rules which appear not to require the element of physical presence,[8] when determining whether South Africa has taxing rights over a NRC. The chapter further examines three potential solutions that can be adopted to enable South Africa to impose income tax on Facebook. The first is the location of Facebook's servers as source and the second is the location of Facebook's ISP or the location of Users' ISPs. The third solution is the adoption of a data royalty tax.

Chapter five investigates whether the solutions recommended in chapter four will conflict with South Africa's international tax obligations since South Africa has observer status in the OECD. The chapter presents the argument that although treaties become part of domestic law, the South African courts are likely to reconcile any conflicts that may occur between provisions of the DTA and the ITA. Facebook is a tax resident of Ireland and Ireland has concluded a DTA with South Africa.[9] To determine which jurisdiction will be entitled to tax the generated profits, this chapter considers the ITA, the common law, Articles 5 and 7 of the DTA and the OECD Model 2017.[10] This chapter also considers the OECD's Pillar One with the application of 'Amount A' and whether it is effective in taxing social media companies.[11]

Chapter six analyses and discusses whether or not the five potential solutions for awarding South Africa taxing rights based on source-based taxation can be implemented.

By way of conclusion, chapter seven comments on the research report's overall findings and reiterates the challenges raised by the data economy with specific reference to Facebook's business model. Chapter six discusses the five potential solutions that can be used by South Africa to tax Facebook effectively.

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[8] *Commissioner for Inland Revenue v Black* 1957 (3) SA 536 (A) at 543B-H.

[9] Convention between the government of the Republic of South Africa and the government of Ireland for the Avoidance of Double Taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains GG 20761 (Published 15 December 1997 and entered into force 5 December 1997. (Hereinafter the DTA)

[10] OECD Model Tax Convention on Income and on Capital: Commentaries on the Articles of the Model Convention available at *https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-2017-full-version_5ac9cc53-en#page1* , accessed 16 December 2022. (Hereinafter the OECD Model 2017). Irish Tax and Customs Certification of Tax Residence for Tax Year 202 avialable at *https://scontent-jnb1-1.xx.fbcdn.net/v/t39.8562-6/275978973_334534328702884_177455121942461089_n.pdf?_nc_cat=108&ccb=1-7&_nc_sid=ae5e01&_nc_ohc=-rPO9XsY9VIAX9rVSgc&_nc_ht=scontent-jnb1-1.xx&oh=00_AfBCZ5iMEiPXTwZB7G1RahbsB0mGQWwEH9udGOdqP3LcIA&oe=65098DD1*.

[11] See explanation of "Amount A" in the abbreviation table. Pillar One seeks to adapt the international income tax system through changes to profit allocation and nexus rules applicable to business profits. See OECD 'Two-Pillar Solution to Address the Tax Challenges Arising from Digitalisation of the economy' available at *https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf*, accessed on 28 December 2022.

PART ONE: A CASE FOR TAXING VALUE GENERATED BY USERS AND THEIR DATA UNDER SOUTH AFRICAN DOMESTIC TAX LAW

2. CHAPTER TWO: TAXING THE DATA ECONOMY

2.1. *Introduction*

We live in a data economy that is based on 'data-rich markets', where data is gradually taking over some of the roles of currency and data analysis is used to predict and modify consumer behavior.[12] Data has become the base ingredient used in the production of wealth as it is used as a unit of account and a medium of exchange .[13] In the case of Facebook, people pay with their data to use the platform. As such, the world's most valuable resource is no longer oil but data.[14] In the data economy, a MNE generates value by harvesting and manipulating data and providing insights to the market to guide consumption behavior.

To illustrate how data can be used to create value and be monetised, the Facebook business model will be examined.[15] As of 2021, South Africa's population consists of approximately 60.14 million inhabitants. It is likely that by 2026 more than half of the South African population will be Facebook users.[16] Facebook is essentially a participative network platform company in that it attracts and retains users by providing them with a free platform, which is Facebook's website or application whilst simultaneously attracting businesses that pay for targeted advertising services to reach the users on Facebook's platforms and benefit from the data that Facebook has of its users.[17] Essentially, Facebook provides a platform where the demand (Facebook users) and supply actors (businesses supplying a product/service) interact with each other.[18]

[12] Shoshana Zuboff 'Surveillance Capitalism and the Challenge of Collective Action'(2019) 28(1) *New Labour Forum* at 12-15.
[13] Kiran Bhageshpur 'Data Is the New Oil—and That's a Good Thing' Forbes 15 November 2019 available at *https://www.forbes.com/sites/forbestechcouncil/2019/11/15/data-is-the-new-oil-and-thats-a-good-thing/?sh=599889cb7304* , accessed on 23 September 2022.
[14] Maurice E Stucke 'Should We Be Concerned About Data-opolies?' (2018) 2 *Geo. l. tech. rev*. at 275-77.
[15]Saifaddin Galal 'Leading social media platforms in South Africa 2021'available at *https://www.statista.com/statistics/1189958/penetration-rate-of-social-media-in-south-africa/*, accessed 18 June 2022.
[16]Saifaddin Galal, 'Total population of South Africa 2022, by age' available at *https://www.statista.com/statistics/1116077/total-population-of-south-africa-by-age-group/*, accessed on 18 June 2022.
[17] Victoria Plekhanova 'Value creation within multinational platform firms: a challenge for the international corporate tax system' (2019) 17 *eJTR* at 281-83.
[18] Anne Helmond, David B Nieborg & Fernando N van der Vlist 'Facebook's evolution: Development of a platform-as-infrastructure' (2019)3(2) *Internet Histories* at 130-34.

2.2. *Users and User data*

Facebook in 2019 was said to have generated 98.5% of its revenue from targeted advertisements on Facebook and Instagram.[19] A plausible case can be made about the contribution of User data to the profitability of a highly digitalised company such as Facebook.[20]

The User engages in a digital barter where they exchange information or data on their preferences and activities which are then processed and monetised by Facebook. Moreover, the User plays a dual role as a producer of valuable information and a consumer of Facebook's digital services. Facebook is therefore built on the collection, analysis and monetising of consumer data by offering consumers desirable digital products in exchange for their personal information.[21] Data is a new asset class that becomes valuable when it is combined with other data or manipulated.[22] It is therefore important to analyse the relationship between source-based taxation and value creation.

2.3. *The connection between source taxation and value creation*

The question of whether data has value is an essential component of justifying user-generated data as a taxable asset. According to Varian,[23] raw data that has not been processed by a company does have some inherent value. Although it is argued that the real value in the case of Facebook is realised from the application of intangible assets such as algorithms,[24] this argument can easily be rebutted on the basis that profits generated by Facebook can still be attributed to the Users on its platforms. As such, in line with Varian's argument, without User data to process there would be no value to realise. This is similar to the mining industry with regard to unmined minerals such as gold when compared to gold that has been mined.

The Facebook business model has resulted in a disconnection between the location of taxation and the location of value creation.[25] The taxation of income is either based on source-based or residence-based

[19] Rishi Lyenga 'Here's how big Facebook's ad business is' CNN Business 1 July 2020 available at *https://edition.cnn.com/2020/06/30/tech/facebook-ad-business-boycott/index.html,* accessed on 22 June 2022.
[20] Plekhanova op cit 17 at 290.
[21] Adam B. Thimmesch 'Transacting in Data: Tax, Privacy, and the New Economy' (2016) 94 *Denv. l. rev*. at 149-51. Also consider Maarten Floris de Wilde 'Sharing the Pie: Taxing multinationals in a global market' (2015) *Intertax* 43.6/7 at 5-7.
[22] 'The World's Most Valuable Resource Is No Longer Oil, but Data' Economist 6 May 2017 available at *https://www.economist.com/leaders/2017/05/06/the-worlds-most-valuable-resource- is-no-longer-oil-but-data,* accessed 22 June 2022.
[23] Varian H. Artificial intelligence, economics, and industrial organization. In The economics of artificial intelligence: an agenda (2018) University of Chicago Press at 399-401.
[24] Ibid at 401.
[25] Angelo Nikolakakis 'Aligning the location of taxation with the location of value creation: Are we there yet?' (2021) *IBFD* 75 11/12 at 449-550.

approaches.[26] One of the arguments for using source and residence-based approaches is that it acknowledges that value creation plays a crucial role in the taxing of profits.[27] Value creation can be defined as the 'process of creating something which did not exist before, of which the outcome is better than the closest alternative available, for which individuals are willing to exchange a monetary amount'.[28] The central principle underpinning the international tax framework is that profits should be taxed where value is created.[29] In using the source-based approach, the focus is on where the value was created in comparison to the residence-based approach where the focus is on who created the value.[30]

2.4. *Conclusion*

The Facebook business model creates value through an active and engaged User base and by soliciting data from Users. The sustained engagement and active participation of Users are critical components of value creation in the business model. The value generated by User participation and data is not captured or accounted for in user jurisdictions which results in Facebook being able to generate significant value from user jurisdictions without the profits they derive from the value being subject to tax. The Facebook business model, therefore, raises a critical question: if tracing money is no longer the most efficient way to convey information about wealth and value because of the role of data, why is data not being used as a tax base? The next section will examine whether Facebook can be taxed under South Africa's domestic tax laws.

[26] Tim Theunis *Profit-allocation based on value creation in the digital economy* (unpublished LLM thesis Lund University 2018) at 11-13.
[27] Ibid at 11.
[28] Ibid at 12.
[29] Werner Haslehner & Marie Lamensch 'Taxation and Value creation' (2021) IBFD at 4.
[30] Nikolakakis op cit 25 at 550.

3. CHAPTER THREE: TAXING FACEBOOK– SOUTH AFRICAN DOMESTIC LAW

3.1. *Establishing a jurisdictional claim*

Before South Africa can levy tax on the business profits, there must be a tax nexus between the taxable amount and South Africa or a connection between the enterprise that received the amount and South Africa.[31] According to Guedes,[32] the tax nexus is the qualified connection between the country that wishes to exercise its taxing power with a taxpayer, or the facts connected to the origin of the taxable object.[33] South Africa uses source-based taxation to bring the income of NRC into the South African income tax net where the income arises or has its originating cause within the territorial boundaries of the country.[34] Contrary to source jurisdiction, when a country establishes a nexus based on residence jurisdiction, the taxpayer is taxable on its worldwide income, without reference to the source of the income.[35] South Africa makes use of residence-based taxation where residents are subject to tax on their worldwide income.[36]

Although South Africa's source rules appear not to require the element of physical presence,[37] it is important to determine whether the source rules can be undermined due to their inability to recognise the value drivers of social media platforms. The nexus rules determine when a state can exercise its tax jurisdiction over a NRC which can be measured by applying the domestic source rules.[38]

3.2. *South African Source Rules*

3.2.1. Meaning of 'source'

In South Africa, non-residents, are taxed on receipts and accruals from income derived from a South African source, in terms of the definition of gross income in s1 of the ITA.[39] In order to determine the source of income, one must consider s9(2) of the ITA, and the common law as formulated by the South African courts and provisions of a DTA.[40]

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[31] Assaf Harpaz 'Taxation of the digital economy: Adapting a twentieth-century tax system to a twenty-first century economy' (2021) 46:17 *The Yale Journal of International Law* at 61-2.
[32] *E.F.* Guedes Lourenço Dantas 'Tax Challenges of the Digital Economy: An Evaluation of the New OECD Nexus Rule Based on Revenue Thresholds' (2022) *Bulletin for International Taxation* 76.4 at 198.
[33] Ibid at 198-9.
[34] Tracy Gutuza 'Tax and e-commerce: where is the source?' (2010) *SALJ* 127.2 at 328-30.
[35] Guedes op cit note 32 at 198-9.
[36] Stjepan Gadžo 'Nexus requirements for taxation of non-residents' business income: a Normative Evaluation in the Context of The Global Economy' (2018) IBFD Doctorial Series at 21-32.
[37] Supra note 8 at 543B-H.
[38] Avi-Yonah, Reuven, Nicola Sartori & Omri Marian 'Global perspectives on income taxation law' (2010) Oxford University Press at 117-120.
[39] Section 1 of the Income Tax Act 58 of 1962.
[40] Ibid s 9(2).

3.2.2. Statutory Source Rules s9(2) of the ITA

Facebook is classified as a service provider, as it generates income from providing advertising services. Facebook is only required to include accruals and receipts arising from a South African source. [41] The ITA has no definition of 'source', although s9(2) provides that an amount is considered to be received by or accrued to a person from a source within South Africa if it constitutes a royalty, dividend, interest or it can be attributable to a PE in South Africa.[42] In analysing s9, one ought to determine whether income generated from users by Facebook falls within one of the categories discussed above. In other words, where income is classified as business income and not royalties or dividends and the amount is not attributable to a PE will s9(2) apply? [43] It seems that business income is not included as one of the categories of income in s9(2) of the ITA and therefore s9(2) will not apply. As the common law remains the residual method for determining the source of income where the category of income is not specifically mentioned in s9,[44] the cases which deal with and set out the rules on determining the source must be considered, in particular the concept of 'originating cause'.[45]

3.2.3. Common law

In the leading case of *CIR v Lever Bros & Unilever Ltd,*[46] the issue before the court related to a consideration of whether interest income earned by Levers ought to be regarded as being from a source within South Africa.[47] Watermeyer CJ confirmed the approach taken in *Overseas Trust Co Ltd v CIR* [48] and *COT v Dunn & Co*[49] which held that 'source' refers to the origin of income and not its location. The court further held that, to determine whether income is from a South African source, it must be established what the originating cause is and then the location of the originating cause must be determined.[50] If there is more than one originating cause, the dominant cause must be ascertained. In applying the principles established in *CIR v Lever Bros & Unilever Ltd* [51] *and COT (SR) v Shein,*[52] the originating cause of income for services rendered is the service supplied and it is located where the service is rendered. In applying *CIR v Lever Bros & Unilever Ltd,* to the digital economy one is confronted by a challenge. Unlike traditional businesses, it is difficult to ascertain in the digital economy the location where digital services are rendered, as the transactions often occur over the internet or on

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41 *Lategan v CIR* 1926 CPD 203, 2 SATC 16 at 19 and *CIR v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), at 19-21.
42 Supra note 39 s 9(2).
43 Ibid s 9(2).
44 *CIR v Lever Bros & Unilever Ltd* 1946 (14) SATC 1 at 6-9.
45 *COT (SR) v Shein 1958* (3) SA 14 (FC), 22 SATC 12 at 15-20.
46 *CIR v Epstein* 1954 (19) SATC 221 at 231.
47 Ibid at 231-32.
48 *Overseas Trust Co Ltd v CIR* 1926 AD 444.
49 *COT V Dunn & Co* 1918 AD 607.
50 Supra note 44 at 6-9.
51 Ibid at 7-8.
52 Supra note 45 at 15-16.

cloud services. As such, clarity would have to be provided as to where digital services are 'deemed' to be rendered if they occur over the internet or on cloud. This means that *CIR v Lever Bros & Unilever Ltd* does not provide a practical solution to the data economy and specifically to Facebook.

3.3. *Conclusion*

Chapter three has shown that South Africa's source rules do not necessarily require the element of physical presence to allocate taxing rights. By applying the common law, it found that the source of income for Facebook services rendered is the service and that the source is located where the service is rendered. However, this principle is more useful in cases of traditional businesses as with services rendered online or electronically, it may be difficult to ascertain where the services are rendered.

4. CHAPTER FOUR: PRACTICAL SOLUTIONS FROM A DOMESTIC TAX LAW PERSPECTIVE

4.1. *Capital in the form of server or ISP*

According to Gutuza, in e-commerce the source of income can be determined based on the location of a server or ISP. [53] However, before determining whether the source could be a server or an ISP, consideration must be given to whether the source of income can be determined in the absence of physical presence. In the case of *Commissioner for Inland Revenue v Black,*[54] the court had to determine whether the use of taxpayer's capital could be used as the source of income. Gutuza, in applying *Commisioner for Inland Revenue v Black,*[55] argues that if the source of income is located at the place where the taxpayer's capital in the form of money is used then by analogy the source of income can be located where capital in the form of a server or ISP is located.[56] In other words, the server or ISP would be the 'originating cause' or source of the taxpayer's income. [57] Where capital in the form of a server or an ISP is the source, it must facilitate the conclusion and execution of contracts, on the server or through an ISP without human intervention.[58] However, in applying the Facebook business model it is likely that the use and authorisation of capital will be located in different countries. Therefore, it may prove challenging to determine the source of income based on the use of capital alone.

Gutuza argues that Schreiner JA's minority judgment in *Commissioner for Inland Revenue v Lever Bros and Unilever Ltd* and *Commissioner for Inland Revenue v Epstein,*[59] is persuasive authority that activity on the part of the taxpayer is not always required to determine the source of income.[60] As such, South Africa seems to have moved away from the physical presence requirement in respect of business income. It is essential to determine whether the location of a server or ISP is appropriate to be used as the location of the originating cause for the Facebook business model.

4.2. *Solution 1: Analysis of using servers as source*

In the case of Facebook, it is likely that servers would not be appropriate to be used as the originating cause because servers are mobile and flexible in nature and therefore do not need any geographic

[53] Gutuza op cit 34 at 333-6.
[54] Supra note 8 at 543B-H.
[55] Ibid at 543B-H.
[56] Gutuza op cit 34 at 333-4.
[57] Ibid at 334.
[58] Ibid at 334.
[59] 1954 (3) SA 689 (A), 19 SATC 221.
[60] Gutuza op cit 34 at 333-4.

connection to the source country or residence country.[61] Moreover, Facebook has entered into a 'long-term strategic cloud provider relationship' with AWS and Facebook has Content Delivery Network Data Centres all over the world.[62] Commentators[63] argue that the location of servers is not an appropriate factor to be used to determine the pre-tax income generated from cloud services because the jurisdiction where the income is generated is often unrelated to the place where the servers are located.[64] Similarly, taxing Facebook using the location of servers will result in several challenges. Likewise, the challenge identified in relation to cloud services with regards to the location of servers not being an appropriate factor to determine where income is generated, applies to the Facebook business model.

Relying on server location for attributing taxing rights to a jurisdiction, incentivises cloud providers to structure their operations so that the income is taxed in favourable tax regimes, by simply placing their servers in jurisdictions with favourable tax rates. As such, relying on the location of servers to tax Facebook will likely result in a mismatch between where revenues are reported and where the Users are located. It is therefore essential to consider whether the location of an ISP could be a more suitable alternative.

4.3. *Solution 2: Analysis of using ISP as source*

An ISP is a service provider, and can be described as a company that supplies connections to the internet for a fee.[65] In addition, ISPs can also provide the service of hosting websites for enterprises likely on their servers.[66]

ISPs can gather sufficient information about Users' online activities. They can track when Users are on Facebook, the duration spent online, the content being consumed and, most importantly, they can confirm the geographic location of Users.[67] ISPs in South Africa can therefore provide SARS with a list of all IP addresses registered to Facebook. In addition to using the information provided by ISPs, relevant indicators can be used to verify information about Users. The indicators would comprise of the

[61] Elma Delic 'Cloudy Jurisdiction: Foggy Skies in Traditional Jurisdiction Create Unclear Legal Standards for Cloud Computing and Technology' (2017) 50 *Suffolk ul rev* 480 at 487.
[62] Sebastian Moss, 'Meta/Facebook turns to AWS as "long-term strategic cloud provider" for acquisitions third-party collaborations, and AI' available at *https://www.datacenterdynamics.com/en/news/metafacebook-turns-to-aws-as-long-term-strategic-cloud-provider-for-acquisitions-third-party-collaborations-and-ai/*,accessed 9 August 2022.
[63] Christopher J Millard, editor. Cloud computing law (2021) 2 Oxford: Oxford Press at 540-4.
[64] *Danish* Skatterådet of *March 15, 2016, SKM 2016, 188 SR,* where the Tax Board ruled that a resident company did not have a PE in a foreign country where it stored its website on a server. See also *Piedras Negras Broadcasting Co v Commissioner* (1941) 43 BTA 297.
[65] An ISP provides services for accessing, using, managing or participating in the Internet.
[66] Par 42.8 of the Commentary on article 5 of the OECD Model Convention.
[67] Basu Subhajit 'Implementing e-commerce tax policy' (2004) 1 *British Tax Review* at 10-33.

following: 1) whether the User is ordinarily resident[68] in South Africa; 2) information on the User's place of residence obtained from data in geolocation or IP address of the User's device; 3) billing address; 4) mobile country code of the phone number of the User; and 5) information on residence inputted by the User.[69] South Africa could then tax Facebook for using User data to generate profits, based on the location of the ISPs of Users.

The abovementioned would need to be in line with POPIA,[70] which gives effect to the constitutional right to privacy by safeguarding personal information that is being processed by SARS.[71] POPIA sets out the minimum standards for accessing and processing personal information in South Africa. Section 1 of POPIA defines 'processing' as collecting, receiving, recording, dissemination or distribution to name a few.[72] Moreover, s1 defines personal information broadly as, 'any information that may identify a person' which includes name, surname, identity number, contact number and even financial information, amongst others.[73] From the abovementioned, it is clear that should SARS tax Facebook based on the location of the ISPs of Users, they would need to process personal information of South African tax residents. The use and dissemination of personal information would be in line with s11(e) of POPIA which states that, personal information may be processed if the processing is necessary for the proper performance of a public law duty by a public body.[74] SARS is South Africa's tax collecting authority established in terms of the South African Revenue Act, 34 of 1997, and it is an organ of the state within the public administration. SARS is responsible for administering the South African tax system and customs services.[75]

4.4. *Solution 3: Applying the taxation of mining and petroleum royalties to taxing Data*

It can be argued that taxing Facebook requires that the data be taxed where the data is collected, similar to the taxation of mining and petroleum royalties. In mining, the mining activity and/or exploration occurs where the minerals are situated.[76] By way of analogy, data is collected where the data is. For example, if Facebook collects data from South African tax residents regardless of where the South

[68] South African Revenue Services 'Income Tax Interpretation Note 3' available at *https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2018-07-Arc-07-IN3-Resident-definition-natural-person-ordinarily-resident.pdf*, accessed 28 December 2022 at 2-6. The ITA does not define ordinarily resident, the courts have interpreted ordinarily resident to mean the country which a person would naturally return from his/her wanderings or a person's principal residence. See *Cohen v CIR* (13) SATC 362 and *CIR v Kuttel* (54 SATC 298).
[69] Subjahit op cit 67 at 10-15.
[70] The Protection of Personal Information Act 4 of 2013.
[71] Ibid at s 1.
[72] Ibid at s 1.
[73] Ibid at s 1.
[74] Ibid at s 11(e).
[75] Tax Administration Act 28 of 2011.
[76] Section 7-12 of The Mineral and Petroleum Resources Development Act 28 of 2002.

African tax residents are situated, and generates income from that data, Facebook should pay tax in South Africa for collecting data in South Africa.

In terms of the Royalty Act, the liability to pay royalties arises when minerals that have been 'extracted' from within South Africa are transferred.[77] The 'transfer' of the mineral resources is the trigger for the imposition of the royalty. [78] The MPRD Act allows the state as custodian of South Africa's mineral and petroleum resources to impose royalties on the transfer of mineral resources.[79] The MPRD Act defines the word 'transfer' to mean the disposal of a mineral resource, consumption, theft destruction or loss of a mineral resource.[80] The term 'mineral resource' is defined to include prospecting rights for minerals, exploration rights for petroleum, mining permits and retention.[81]

4.4.1. Calculation of royalty and the Data Royalty tax

The Royalty Act,[82]distinguishes between a 'refined mineral resource' and an 'unrefined mineral resource' which are listed in Schedule 1 and Schedule 2.[83] An example of a refined mineral resource includes gold processed to at least 99.5% purity or platinum processed to at least 99.9% purity compared to unrefined mineral resources which include rough diamonds and 80% uranium oxide in the uranium concrete sold.

The formulae distinguish between refined and unrefined minerals by capping refined minerals at 5% and refined minerals resources at 7%. [84] The formulae make use of two variables and three parameters to calculate the royalty liability:

- the value of the minerals (the tax base);
- a royalty percentage rate (calculated in a prescribed manner) which is applied to the base;
    - EBIT; [85]
    - gross sales; and

[77] Section 2 of the Mineral and Petroleum Resources Royalty Act 28 of 2008.
[78] Ibid s 2.
[79] Supra note 76 s 1.
[80] Ibid s 1.
[81] Ibid s 1. See also P.O Akinseye & F.T. Cawood 'The South African mining royalty regime: Considerations for modifying the system to balance its competing objectives' (2021*)* 121(12), *Journal of the South African Institute of Mining and Metallurgy* at 633-8.
[82] Ibid s 1.
[83] Ibid s 1.
[84] Supra note 77 s 4(1) and 4(2).
[85] Ibid s 5.

- constants of either 9 or 12.5, depending on whether the mineral resource is refunded or unrefined.[86]

For refined mineral resources, the formulae to determine the percentage or rate (to be applied to the tax base) is: 0.5 + [EBIT / (gross sales in respect of refined mineral resources x 12.5)] x 100. While for unrefined mineral resources the formula is: 0.5 + [EBIT / (gross sales in respect of unrefined mineral resources x 9)] x 100. The aforementioned formulae may provide a foundation for taxing data that has been extracted from a South African source (that is, South African tax residents) but not processed and refined in South Africa.[87] The second formula could be applied to the gross sales generated from targeted adverts, that make use of the data from South African tax residents. Where the data extraction, processing and refining occurs in South Africa (meaning that data is extracted from South African tax residents and the data is mined in South Africa) then it should be taxed according to the refined mineral resources formulae.[88] The constants and EBIT would need to be varied to suit the taxation of data.

4.5. *Conclusion*

This chapter explored three potential solutions for taxing data from a domestic tax perspective. The solutions recommended comprised of using the common law approach of taxing Facebook based on the location of its servers, taxing Facebook based on the location of its ISP or Users' ISPs and making use of the refined and unrefined mineral resources formulae to create a data royalty tax.

[86] Betsie Strydom 'South Africa -Mining and Petroleum Royalties- The Imposition and calculation' (2012) Bowman Gilfillan available at *https://bowmanslaw.com/article-documents/South-Africa-Mining-and-Petroleum-Royalties.pdf*, accessed on 20 December 2022 at 2-4.
[87] Akinseye P.O *Modifying the South African mining law royalty regime for optimal mineral resource use and management of mineral rents* (unpublished PHD thesis University of Witwatersrand 2019) at 6-11.
[88] Ibid at 6-8.

PART TWO: INTERNATIONAL TAX AND THE APPLICATION OF TREATIES

5. CHAPTER FIVE: APPLICATION OF THE DTA TO DOMESTIC LAW

5.1. *Introduction*

To determine which jurisdiction will be entitled to tax Facebook's profits, the ITA, and Articles 5 and 7 of the DTA must be considered. For South Africa to tax Facebook based on the location of Facebook's servers, Users' ISP, or a data royalty tax, it will have to consider whether there will be any conflicts with its international obligations. Currently, the ITA does not stipulate whether the ITA or tax treaty prevails where there is conflict. Section 233 of the Constitution provides that when interpreting legislation, the courts must prefer any reasonable interpretation of legislation that is consistent with international law over any alternative interpretation that is inconsistent with international law. As such, it could be argued that in applying s233 of the Constitution, the courts ought to choose the middle ground which is to reconcile any conflicts that may occur between provisions of a tax treaty and the ITA.[89]

For purposes of this dissertation it is assumed that Facebook is a tax resident of Ireland and South Africa has entered into a DTA[90] with Ireland. The DTA has since been incorporated into South Africa's domestic law. However, it is important to determine whether international agreements are awarded privileged status in South African law, where provisions of the DTA and the provisions of the ITA conflict.[91]

5.2. *Application of international agreements to domestic law*

Section 108(2) of the ITA[92] read in conjunction with s 231(4) of the Constitution,[93] provides for relief from double taxation by empowering the National Executive to enter into an agreement with the governments of other countries. Thus, a DTA does not form part of domestic law until it is incorporated into domestic law by legislation.[94]

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[89] The Constitution of the Republic of South Africa 1996 (hereinafter the Constitution).
[90] DTA op cit 9.
[91] Du Plessis I 'Some Thoughts on the Interpretation of Tax Treaties in South Africa' (2012) 24 *SA Merc LJ*,31-52.
[92] Supra note 39 s 108(2).
[93] Supra note 89 s 231(4).
[94] 1965) 3 ALL SA 24 (A) paras 140-180.

This was confirmed by the Supreme Court of Appeal in *Commissioner for the South African Revenue Service v Tradehold Ltd*,[95]in examining the DTA between South Africa and Luxembourg. The court confirmed that s108 serves as the national legislation that is required to domesticate a DTA entered into by the national executive and approved by parliament. However, it is important to examine whether once a DTA forms part of South African law, it ranks higher, lower or on par with the ITA. This question lies at the heart of the debate when a conflict arises between the ITA and the DTA.

In *Glenister v President of South Africa*, [96]the minority and majority judgments held that domestic statutory obligations are created once a treaty is domesticated through legislation. The minority was of the opinion that, where there is a conflict between domesticated international agreements and domestic legislation, the conflict should be resolved by applying principles of statutory interpretation and superseding legislation. This view was later followed by the court in C*ommissioner for the South African Revenue Service v Van Kets*,[97]as the court found that the provisions of a double taxation treaty rank on par with domestic law. Furthermore, the court held that where there is a conflict between the provisions of an act and a double taxation treaty, the two should be reconciled and read as one coherent whole.[98] The court in *Krok v CSARS*, [99] confirmed that articles 31 and 32 of the Vienna Convention are rules of customary international law and therefore binding in South Africa. South African courts will therefore be bound to apply the rules of the Vienna Convention when interpreting double taxation agreements unless the Vienna Convention conflicts with the Constitution.[100]

5.3. *Articles 5 and 7 of the Double Tax Agreement*

The nexus framework for business income taxation has been established in Articles 5 and 7 of the DTA.[101] Article 7(1) of the DTA provides that, 'profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein'.[102] This means that profits derived by an enterprise are taxable exclusively by the state of residence unless the enterprise carries on a business in the source state through a PE situated therein.[103] In practice, Article 7 of the DTA allocates taxing rights of business profits earned by Facebook to South Africa only if Facebook carries on a business in South Africa through a PE and the profits generated are attributable to the PE.[104] To determine whether Facebook

[95] *Commissioner for the South African Revenue Service v Tradehold Ltd* 2012 (3) All SA 15 (SCA) paras 24-7. See also Du Plesis op cit 91 at 31-40 on the ranking order of DTA in comparision to the ITA.
[96] *Glenister v President of the RSA* 2011 (3) SA 347 (CC) para 181.
[97] *Commissioner for the South African Revenue Service v Van Kets* 2012 (3) SA 399 (WCC) para 18.
[98] Ibid para 181. See also Du Plessis op cit 91 at 31-52.
[99] *Krok v CSARS* 2015 (78) SATC 1 paras 27-30.
[100] Article 31(3) of the Vienna Convention on the Law of Treaties (adopted 23 May 1969, entered into force 27 January 1980), 1155 UNTS 331.
[101] DTA op cit 9 articles 5 and 7.
[102] Ibid.
[103] *Secretary for Inland Revenue vs. Downing* (1975) 4 SA 518 (A) at 255-7.
[104] DTA op cit 9 article 7(1).

has established a PE in South Africa, section 1 of the ITA read with Article 5 of the DTA must be considered. Article 5 provides a threshold that determines the circumstances in which a non resident company like Facebook is considered to have a sufficient level of economic activity to justify taxation in South Africa.[105]

Article 5(1) of the DTA, defines a PE as a 'fixed place of business through which the business of an enterprise is wholly or partially carried on'.[106] In applying Article 5(1) of the DTA between South Africa and Ireland, in order for Facebook to establish a PE in South Africa it would need to have established the following: (i) the existence of a 'place of business'; (ii) the existence of a 'fixed' place of business; and (iii) the carrying on of the business of the enterprise 'through' this fixed place of business. Article 5(2) of the DTA, goes on to provide a non-exhaustive list of examples of PEs such as a place of management, a branch, an office, a factory, a workshop and a place of extraction of natural resources. Furthermore, Article 5 of the DTA, defines a dependent agent that constitutes a deemed PE for a NRCs, provided that all the relevant requirements are met.[107] It is the author's understanding that based on interpretation of article 5(1), the taxation of Facebook's business income is likely to be exclusively allocated to Ireland, unless Facebook has a PE or a dependent agent in South Africa.[108] The aforementioned disregards the digitalisation of the economy that has increased the possibility for Facebook to operate remotely and exploit the South African markets without paying its fair share of taxes in South Africa.[109] However, the OECD published its 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the economy' to address this problem.[110]

The OECD's Pillar One and Two must be considered as it aims to address the challenges of the digitisation of the economy. Pillars One and Two attempt to address the tax challenges of the digitalisation of the economy that were identified for direct taxes in the 2015 BEPS Action 1 Report.[111] It is important to note that the recommendations made in Pillars One and Two may be implemented in multilateral treaties in the near future.

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[105] Ibid article 5(1).
[106] Ibid article 5(1).
[107] Ibid article 5(2).
[108] Ibid article 5(2).
[109] Dantas *op* cit 32 at 198.
[110] OECD 'G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy' available at *https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf,* accessed 9 August 2022 at 1-3.
[111] OECD 'Action 1 Final Report 2015- Addressing the Tax Challenges of the Digital Economy' available at *https://read.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en#page1*, accessed 9 August 2022 at 5.

5.4. *The OECD Two Pillar Solution*

Pillar One aims to re-allocate profits of the largest most profitable MNEs to jurisdictions where the customers and users of those MNE are located.[112] Pillar Two can be briefly be described as introducing a global minimum tax rate of 15% for MNEs with a revenue greater than €750 million.[113]For purposes of this research report, the author will only discuss Pillar One because the application of Pillar Two will be of little value to South Africa, as South Africa's corporate tax rate is 28% which is above the proposed minimum tax rate of 15%.

5.4.1. Application of Pillar One

Pillar One makes use of two types of profits that may be allocated to a market jurisdiction described as Amount A and Amount B.[114] For purposes of this research report the discussion and analysis will be limited to Amount A and in particular the scope, nexus, quantum and revenue sourcing rules.[115] This chapter limits the scope to Amount A as Amount B is mainly concerned with the simplification and streamlining measures in applying the arm's length principle to in-scope transactions.[116]

Pillar One's scope is limited to MNEs with a global turnover above €20 billion and profitability of above 10% (profit before tax/revenue),[117]the turnover threshold may be reduced after 7 years to €10 billion.[118] Pillar One also establishes a new special nexus rule that allocates Amount A to a market jurisdiction provided that first, the MNE falls within the scope and secondly, that it derives at least € 1 million in revenue from the jurisdiction in question.[119] In an attempt to make Pillar One more inclusive for developing economies, smaller jurisdictions with a GDP lower than €40 billion will have a reduced nexus threshold set at €250 000.[120] Once it has been established that a jurisdiction qualifies for Amount A, only 20-30% of the in-scope MNE's residual profits will be allocated to the market jurisdiction using a revenue-based allocation key.[121] The residual profit is defined as profit in excess of 10% of revenue.

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[112] OECD 'Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project' available at https://read.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-report-on-pillar-one-blueprint_beba0634-en#page7 , accessed 9 August 2022.
[113] Ibid.
[114] Market jurisdiction refers to the state where the customers are located.
[115] OECD 'Public Consultation Document, Secretariat Proposal for a "Unified Approach" under Pillar One' available at *https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf*, accessed 9 August 2022 at 4.
[116] OECD 'Pillar One- Amount A Public Consultation Document' available at *https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-b-2022.pdf*, accessed 28 December 2022 at 8-13.
[117] Ibid.
[118] Ibid.
[119] Zinhle Novazi *The New OECD Nexus Rule or a Fox in Sheep's clothing? A critique of the revenue threshold* (unpublished master's dissertation, Queen Mary University of London 2022) at 25-35.
[120] Ibid at 25.
[121] Ibid at 25-26.

Pillar One Amount A is largely skewed in favour of developed countries as it fails to consider that MNEs that may be considered to be SMEs for a developed country may not necessarily qualify as such in the economies of developing countries like South Africa.[122] Although the nexus permitting the allocation of Amount A to market jurisdiction is to be set at €250 000 for smaller jurisdictions with a GDP of less than €40 billion, MNEs would still need to fall into the scope by meeting the €20 billion global turnover requirement.[123] This essentially excludes developing countries like South Africa from benefiting from the new rules mainly because the rules are based on monetary thresholds which relate to profit.

5.5. *Conclusion*

This chapter has discussed how a potential conflict between South Africa's ITA and a DTA can be resolved by examining how the South African courts have resolved similar conflicts. According to the principles established in *Glenister, van Kets* and *Krok* [124] where there is a conflict between domesticated international agreements and domestic law, the conflict should be resolved by applying statutory interpretation and/or reconciling the conflicts between the two. In addition, this chapter has applied Articles 5 and 7 of the DTA and found that the taxation of Facebook's business income is exclusively allocated to Ireland unless Facebook has a PE or a dependent agent in South Africa. [125] This position can be criticised for disregarding the digitalisation of the economy given that Facebook can operate remotely in South Africa's market without a PE. However, South Africa's common law source rules make provision for income to be deemed to be from a South African source without requiring physical presence which is more progressive than the DTA.

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[122] Annet Wanyana Oguttu, 'A critique from a developing country perspective of the proposals to tax the digital economy' (2020) World Tax Journal*: WTJ* 12.4 at 799-801.

[123] OECD, '/G20 Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy' available at *https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf,* accessed 9 August 2022 at 1-3.

[124] Supra note 95 at paras 24-7 and supra note 96 at paras 181-2.

[125] DTA op cit 10 article 5 and 7.

6. CHAPTER 6: EVALUATION AND APPLICATION OF PROPOSED SOLUTIONS

Chapter six evaluates five potential solutions that can be used to generate a nexus between Facebook and Users and the user's jurisdiction and it also examines the limitations of implementing each solution.[126]

6.1. *Solution 1 -Source at the location of the server*

South Africa's common law allows for the source of income to be located where capital in the form of a server is used.[127] It can be argued that, in terms of the DTA, a server may fulfil the prerequisite for a 'fixed' place of business provided that it constitutes a piece of equipment that remains on a particular site for a sufficient period of time and therefore provides the business with a certain degree of permanency.[128] However, it is likely that electronic operations carried on through the servers will be considered to be preparatory or auxiliary in nature and will not give rise to a PE.[129]

The DTA could potentially make provision for South Africa to tax Facebook, provided Facebook's servers are located in South Africa. Facebook has entered into a 'long-term strategic cloud provider' with AWS and they also have Content Delivery Network Data Centres all over the world. As a result, the location of servers may not be an appropriate solution.[130] This is especially because the jurisdiction where Facebook generates income from User data may often be unrelated to the place where the servers are located.[131] As such, it is important to consider whether the location of an ISP might be more suitable.

6.2. *Solution 2 -Source at the location of the ISP*

South Africa's common law allows for the location of the source of income to correlate with where capital in the form of ISP is used. The issue of whether an ISP located in South Africa can be deemed to be a dependent agent of Facebook to create a PE in South Africa is addressed in the OECD Model 2017 and the DTA.[132] ISPs do not constitute dependent agents for NRC as they often lack the authority to conclude contracts in the name of the enterprise and they do not regularly conclude such contracts.[133]

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[126] Yang Lu-ming, Xiaoling Li & Jian Liang 'The Establishment of the Tax System under the E-commerce Environment' (2008) International Seminar on Future Information Technology and Management Engineering. IEEE at 333-34.
[127] Ibid at 334.
[128] Commentary on Art 5 para 123 of the OECD Model 2017.
[129] Ibid article 5 para 123.
[130] OECD 'Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?' available at *https://www.oecd.org/tax/treaties/35869032.pdf*,accessed 9 August 2022 at 30-44.
[131] The Tax Board ruled that a resident company did not have a PE in a foreign country where it stored its website on a server.
[132] Lu-ming, Li & Liang op cit 126 at 333-34.
[133] Ibid at 334.

As such, in the event that Facebook makes use of an ISP, the ISP would likely be independent agents acting in the ordinary course of business when it hosts websites of many different businesses.

In practice, a MNE such as Facebook do not use services provided by ISPs as they have several servers in different countries or they enter into partnerships with companies such as AWS. However, this research report has provided an alternative solution of using the location of the ISP of Users as the 'originating cause' or source of Facebook's income.[134] In other words, South Africa could address the challenges of the data economy by adopting the method of taxing Facebook based on the location of the ISPs of Users.[135] To verify that the Users are South African tax residents the ISPs in question would have to provide SARS with information regarding the Users. As discussed earlier, the information provided by the ISPs should be paired with relevant indicators that can be used to verify information about Users.[136] However, given that the solution has not been implemented before, one may consider solution three which is based on the formulae used to tax royalties in mining.

6.3. *Solution 3: Royalty tax for data*

Article 6(2) of the DTA, provides that the source of mining income is where the mine is situated.[137] As such, income derived from the direct use of a mine is taxable in the state in which the mine is situated. This means that South Africa as the source state, would have the primary right to tax data that has been collected from its tax residents.

Data can be considered to be a raw commodity and it can be taxed as such. As with raw commodities, data located within a state and/or data that belongs to South African tax residents belongs to the state.[138] This implies that a NRC wishing to extract data from South African tax residents, must pay for a 'concession' in the form of a data royalty tax.[139] In practice, data royalties can be collected based on the volume and value of data extracted, on progressive rates that increase and the rate that data is being mined or processed. The rate will essentially increase as the profit ratio increases. [140] The benefit of implementing a data royalty from a government perspective is that it is easier to administer compared to the other solutions that have been recommended. South Africa would be able to earn revenue off royalties on licences to collect data from South African tax residents.[141] Royalties on the right to collect

[134] DTA op cit 9 article 6(2).
[135] Ibid article 6(2).
[136] Ibid.
[137] Ibid.
[138] C Nakhle '4 Petroleum fiscal regimes: evolution and challenges' The Taxation of Petroleum and Minerals (2010) Routledge at 120-137.
[139] Ibid.
[140] EM Sunley, T Baunsgaard & D Simard 'Revenue from the oil and gas sector: Issues and country experience' *Fiscal policy formulation and implementation in oil-producing countries* at 153-183.
[141] Ibid at 156-160.

data can also be designed to be progressive and increase with the amount of data collected. Thus, imposing a data royalty tax may be a viable option for taxing the data economy.

6.4. *Solution 4: The OECD Pillar One*

The Pillar One special nexus rule would determine whether South Africa qualifies for the Amount A Allocation. Facebook was reported to have made a revenue of $ 117,929 billion and a net income of $ 39,370 billion in 2021.[142] As such, Facebook is likely to meet Pillar One's scope of a global turnover of above €20 billion and a profitability threshold of 10%.[143] Furthermore, Facebook is expected to derive at least € 1 million in revenue from South Africa. However, given that South Africa has a GDP lower than €40 billion, the applicable nexus threshold is set at €250 000.[144] This research report is unable to ascertain the revenue generated by Facebook from South Africa, therefore for the purposes of this research report, it will be assumed that Facebook is likely to meet the revenue threshold of €250 000. Once it has been established that South Africa qualifies for Amount A, only 20-30% of Facebook's residual profits will be allocated to South Africa using a revenue-based allocation key.[145] The revenue threshold of €250 000 essentially replaces the need to establish a PE by using a revenue threshold as the primary indicator for a significant and sustained engagement.[146]

The revenue threshold can be criticised for not fully addressing the direct tax challenges of the digital economy. First, Pillar One represents a move away from addressing the challenges of the digital economy due to its limited scope.[147] As such, the proposal oversimplifies a highly nuanced and complex challenge presented by Facebook's business model. Secondly, it is questionable whether the revenue test is an accurate way of demonstrating a qualified connection between a taxpayer and the market jurisdiction.[148]Thirdly, according to an article by KPMG,[149] the World Bank has reported that jurisdictions that fall within the €40 billion GDP threshold comprise less than 2% of the total global

142 S Dixon 'Meta: annual revenue and net income 2007-2021'available at *https://www.statista.com/statistics/277229/facebooks-annual-revenue-and-net-income,* accessed 18 August 2022.
143 Ibid.
144 Michael Devereux & Martin Simmler, 'Who Will Pay Amount A?' (2021) 5 EconPol Policy Brief 36/2021 at 2-4.
145 Ibid at 3.
146 Ibid at 4.
147 OECD 'Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors' available at *https://www.oecd.org/tax/oecd-secretary-general-tax-report-g20-finance-ministers-october-2021.pdf* , accessed 9 August 2022 at 4-5.
148 Dantas op cit 32 at 198-199.
149 KPMG 'OECD/G20 Inclusive Framework Agreement on BEPS 2.0' available at *https://home.kpmg/xx/en/home/insights/2021/07/etf-452-oecd-g20-inclusive-framework-agreement-on-beps-2-0.html*, accessed 9 August 2022.

GDP.[150] This means that MNEs that fall outside the scope of Amount A would have to pay taxes on profits in their resident jurisdiction or source jurisdiction where they have PEs established.[151]

Consequently, it is debatable whether Pillar One is an effective solution for the challenges of the data economy. Although the OECD has moved in the right direction by creating a new non-physical nexus, a more effective solution would be to rely on User data and User participation as a more accurate way of demonstrating a qualified connection between Facebook and South Africa. [152] It may be worthwhile to explore the fourth solution which is for South Africa to adopt unilateral measures by examining the approaches adopted by India and Nigeria.

6.5. *Solution 5 Unilateral measures – Following in the Steps of India and Nigeria*

6.5.1. India

For a NRC to be taxed in India, there must be a 'business connection'.[153] A business connection can be established either when a revenue-linked condition is established or when a user-linked condition exists.[154] For the purposes of this research report, the discussion is limited to the user-linked condition. The user-linked condition entails a systematic and continuous soliciting of business activities or engaging with users in India, provided that such activities exceed the threshold of 300,000 Indian users and a revenue threshold of INR 20 million.[155] India's SEP provision specifically looks at NRC that advertise by targeting customers who reside in India or who access advertisements through an IP address located in India.[156] The provision also includes the sale of data collected from persons who either reside in India or have IP addresses located in India.[157]

India's SEP provision is similar to the proposed solution for South Africa to rely on the server of the User's ISP, as the source of income for NRC.[158] It also makes use of a threshold of users which is similar to the OECD's Pillar One revenue threshold. However, India has been confronted with challenges in

[150] Ibid.
[151] Devereux & Simmler op cit 144 at 2-3.
[152] Marcel Olbert & Spengel Christoph 'International Taxation in the Digital Economy: Challenge Accepted' (2017) 9.1 *World Tax Journal* at 3-8.
[153] Section 9(1)(i) of the ITA. See also Ernest & Young 'India issues threshold for triggering "significant economic presence" in India' available at *https://taxnews.ey.com/news/2021-0943-india-issues-thresholds-for-triggering-significant-economic-presence-in-india*, accessed on 30 September 2022.
[154] Ibid s 9(1)(i).
[155] Ernest & Young op cite 153.
[156] Khurana Karanjot Singh & S. Vasudevan 'Significant economic presence in Indian tax law: How significant will it be?' (2021) *International Tax Review*.
[157] Ibid.
[158] Ibid.

implementing the SEP provisions and thresholds.[159] The first challenge was deciding whether the INR 20 million revenue threshold was to be determined on gross or net sales returns. Secondly, in defining a user in India, the SEP provisions failed to provide a method of how the 300 000 users should be determined.[160] Thirdly, the provisions did not specify whether any distinction should be made between active and passive users.

Fourthly, the expanded scope of 'business connection' as a domestic tax provision does not override international tax treaties that make use of the traditional PE definition. As such, NRC that have entered into a tax treaty with India will be unaffected by the SEP provisions.[161] India's case study takes the approach of ranking international treaties above domestic law, which is distinguishable from the approach adopted by the South African courts.[162] It might be worthwhile to also consider the position adopted by Nigeria.

6.5.2. Nigeria

Unlike India, the SEP order in Nigeria states that NRC that provides digital services, technical, professional, management or consultancy services to Nigerian customers, will be deemed to have taxable nexus and therefore liable to tax in Nigeria.[163] Nigeria's Financial Act, has expanded the conditions under which NRC income would be taxable in Nigeria.[164] Similar to India, Nigeria has SEP thresholds which is a gross turnover or income in excess of ₦25million (about US$65000) which is generated in any year from any of the activities listed in the SEP order.[165]

With regard to international agreements, Nigeria's domestic law gives multi-lateral agreements or tax agreements preference over the domestic SEP Order.[166] Like India, Nigeria values treaty supremacy and as a result, NRC that have entered into a DTA with Nigeria will be unaffected by the SEP Order unless changes are made to the DTA.[167] Based on the case studies discussed above, should South Africa adopt a unilateral domestic approach to taxing Facebook, it is likely to be confronted by resistance from

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[159] Pant Ameya & Dipesh Jain 'Complexities surrounding SEP cases in India: An overview of decisions by the High Court and Competition Commission of India' (2018) 13(2) *Journal of Intellectual Property Law & Practice* at 132-5.
[160] Singh & Vasudevan op cit 156.
[161] Ibid.
[162] Ibid.
[163] Section 6(A) of the Personal Income Tax Act (as amended). See also the Federal Republic of Nigeria Official Gazette Government Notice No 21 Volume 107 (Lagos 10 February 2020).
[164] The Financial Act, 2021. See also Obayemi Olumide 'Country Note: Taxing The Income of Digital Non-Resident Companies Under The 'Significant Economic Presence (Sep) Rules In Nigeria' (2021) 49.5 Intertax 449.
[165] Companies Income Tax Act, 1961. See also PWC 'Nigeria Issues Significant Economic Presence Order' available at *https://www.pwc.com/ng/en/assets/pdf/significant-economic-presence-order-may2020.pdf*, accessed 15 October 2022.
[166] Ibid.
[167] Ibid.

Ireland. Using the location of an ISP as source in South Africa would affect the interpretation of the DTA.

6.6. *Conclusion*

This chapter has discussed the benefits and the limitations of adopting the five potential solutions that will award South Africa taxing rights over Facebook's business profits. It is likely that solution four, which requires the adoption of the OECD's Pillar One will be the more popular option to be implemented as it does take into account alternative methods that can be used to tax the digital economy, which can be applicable to companies such as Facebook.

7. CHAPTER 7: RECOMMENDATIONS

This research report has highlighted the challenges pertaining to the digitalisation of the economy with specific reference to the Facebook case. Given the rate at which Facebook is monopolising the aggregation and analysis of personal data to monetise the data[168]this research report has suggested five potential solutions that can be adopted by South Africa to tax Facebook efficiently.

First, this research report has analysed and illustrated the challenges in adopting solution one which entails taxing Facebook's business profits based on the location of its servers.[169] Secondly, this research report has recommended that solution two be adopted, which entails using the location of the ISPs of Users as the 'originating cause' or source of Facebook's income.[170] In addition, this research report has addressed potential concerns that may arise from a data protection aspect with regard to the processing of personal information should option two be implemented. This research report also considered the possibility that should South Africa implement solution two there would be a potential conflict between the ITA and the DTA, it therefore applied case law (*Glenister, van Kets* and *Krok)* and opined that the courts are likely to reconcile the conflicts between the two.

Thirdly, this research report has discussed and proposed solution three, an innovative method of taxing data as a royalty based on the existing model of how South Africa taxes mining royalties.[171] Fourthly, it has considered the OECD's Pillar One as solution four, which should enable South Africa to tax Facebook by allocating of Amount A to a market jurisdiction which is South Africa.[172] Fifthly, solution five advocates for South Africa to follow in India and Nigeria's footsteps by adopting unilateral measures to taxing the data economy.[173]

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[168] Lyenga op cit 19.
[169] Gutuza op cit 34 at 333-4.
[170] Ibid at 334.
[171] Strydom op cit 86 at 3.
[172] Novazi op cit 119 at 27.
[173] Olumide op cit 164 and Singh & Vasudevan op cit 156.

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